Free Movement of Capital, Third Country Relationships and National Tax Law: An Emerging Issue before the ECJ

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1. Introduction

Compared to the other EC Treaty freedoms, the free movement of capital stands out in several ways. From a historical perspective, it is particularly striking that this fundamental freedom appears to have been "left behind" for many years by all of the parties involved, i.e. the Member States when they concluded the Treaty on the European Economic Communities in Rome in 1957, the Community institutions when they began to harmonize national legal systems and the European Court of Justice (ECJ) when it started to instil life into the different freedom guarantees set out in the Treaty itself. Briefly, it can be said that Art. 67 to Art. 73 of the EEC Treaty played an insignificant role for several decades. This was despite the fact that the wording of Art. 67(1) of the EEC Treaty appeared to be quite promising:

During the transitional period and to the extent necessary to ensure the proper functioning of the common market, Member States shall progressively abolish between themselves all restrictions on the movement of capital belonging to persons resident in Member States and any discrimination based on the nationality or on the place of residence of the parties or on the place where such capital is invested.

Still, the fate of this obligation to achieve the liberalization of capital movements between Member States was inextricably linked with, inter alia, Art. 69 of the EEC Treaty which, as far as it is relevant in the present context, stated in broad terms that "[t]he Council shall, on a proposal from the Commission, ... issue the necessary directives for the progressive implementation of the provisions of Article 67 ..." As the necessary Directives were only adopted slowly in the transitional period (which, under Art. 8 of the EEC Treaty, ended on 31 December 1969)

and subsequently,¹ and as these had a rather narrow focus that was reflected in their different annexes, the ECJ decided that Art. 67 of the EEC Treaty lacked direct applicability in many areas,² including that of direct taxation.³ It was only with the enactment of Council Directive 88/361/EEC⁴ in June 1988 that the area of capital movements finally received a fresh and strong impetus. Specifically, Art. 1(1) of this Directive stated that:

Without prejudice to the following provisions, Member States shall abolish restrictions on movements of capital taking place between persons resident in Member States. To facilitate application of this Directive, capital movements shall be classified in accordance with the Nomenclature in Annex I.

Whilst it took a few years until the ECJ had an opportunity to rule on this provision, in its *Bordessa* judgment of February 1995, the Court then made it clear that the Directive had "brought about the full liberalisation of capital movements" and that

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- See, in particular, First Council Directive for the implementation of Article 67 of the Treaty of 11 May 1960, Official Journal, 1960, 921 (English Special Edition, 1959-1962, 49) and Second Council Directive 63/21/EEC of 18 December 1962 adding to and amending the First Directive for the implementation of Article 67 of the Treaty, Official Journal, 1963, 62 (English Special Edition, 1963-64, 5). Compare also Council Directive 85/583/EEC of 20 December 1985 amending the Directive of 11 May 1960 on the implementation of Article 67 of the Treaty, Official Journal, 1985, L 372/39 and Council Directive 86/566/EEC of 17 November 1986 amending the First Directive of 11 May 1960 for the implementation of Article 67 of the Treaty, Official Journal, 1986, L 332/22. On these historical developments, see C.W.M. van Ballegooijen, "Free Movement of Capital in the European Economic Community", Legal Issues of Economic Integration (1976/2), p. 1 et seq. and P. Oliver, "Free Movement of Capital Between Member States: Article 67(1) EEC and the Implementing Directives", 9 European Law Review (1984), p. 401 et seq.
- 2. See ECJ, 11 November 1981, Case 203/80, Criminal proceedings against Guerrino Casati [1981] ECR 2595, Para. 8 et seq. and the detailed analysis by E. Steindorff, "Kapitalverkehrsfreiheit in der EG nach Casati", in W. Hadding et al. (eds.), Festschrift für W. Werner (Berlin/New York: de Gruyter 1984), p. 877 et seq. Compare also ECJ, 31 January 1984, Joined Cases 286/82 and 26/83, Graziana Luisi and Giuseppe Carbone v. Ministero del Tesoro [1984] ECR 377, Para. 30 and ECJ, 24 June 1986, Case 157/85, Luigi Brugnoni and Roberto Ruffinengo v. Cassa di risparmio di Genova e Imperia [1986] ECR 2013, Para. 21 et seq.
- 3. See ECJ, 21 September 1988, Case 267/86, *Pascal Van Eycke v. ASPA NV* [1988] 4769, Para. 21 et seq.
- 4. Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty, Official Journal, 1988, L 178/5. Compare, in this respect, P. Oliver and J.-P. Baché, "Free Movement of Capital Between the Member States: Recent Developments", 26 Common Market Law Review (1989), p. 60 et seq.

the requirement under Article 1 of the Directive for Member States to abolish all restrictions on movements of capital is precise and unconditional and does not require a specific implementing measure.⁵

Accordingly, taking account of the ECJ's general case law on the direct effect of norms in Directives,⁶ a broad prohibition of "restrictions" on capital movements between Member States applied once the deadline for the transposition of the Directive into domestic law, i.e. 1 July 1990, had expired.⁷ In its subsequent *Verkooijen* decision of June 2000, the ECJ clarified that the prohibition also applied in the area of direct taxes, as, "although direct taxation falls within their competence, the Member States must none the less exercise that competence consistently with Community law", including secondary EC legislation.⁸

Yet, whilst the ECJ was still concerned with the clarification of the effects of Directive 88/361/EEC on domestic legal systems in general and on the direct tax systems of the Member States in particular, an important development then took place at the level of primary EC law. As a result of the negotiation of the Maastricht Treaty on the European Union, the previous provisions in Art. 67 to Art. 73 of the EEC Treaty were replaced by the new Art. 73b to Art. 73g of the EC Treaty with effect from 1 January 1994.9 In particular, the wording of the new Art. 73b(1) of the EC Treaty was quite remarkable. This provision stated that

Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.

It was only shortly after the *Bordessa* judgment, and on the basis of very similar factual circumstances and national procedures, ¹⁰ that the ECJ had the opportunity to interpret the scope of the new Art. 73b(1) of the EC Treaty. In its *Sanz de Lera* decision of December 1995, the ECJ took two important steps. First, the ECJ simply transferred its interpretation of Art. 1(1) of Directive 88/361/EEC to Art. 73b(1) of the EC Treaty and stated that the latter provision

gave effect to the liberalisation of capital movements between Member States and between Member States and non-member countries.

Second, the ECJ responded to the explicit questions referred to it by the national court and added, in rather clear words, that due to the new EC Treaty rule,

all restrictions on the movement of capital between Member States and non-member countries are to be prohibited. ¹¹

Against this background, and with the key provisions on the free movement of capital having been re-numbered into Art. 56 to Art. 60 of the EC Treaty but otherwise left unchanged by the EC Treaty revision effected by the Amsterdam Treaty, it is hardly surprising that the direct application and the broad scope of Art. 56(1) (previously, Art. 73b(1)) has never really been questioned in situations *between Member States*. On the contrary, it can be stated that the free movement of capital has fully joined the "convergence process" of all of the fundamental freedoms¹² and that its strong influence on national reg-

ulation has been recognized by the ECJ in consistent jurisprudence with regard to all legal areas, ¹³ including, in particular, direct taxation. ¹⁴ In so far, it can be said,

- 5. ECJ, 23 February 1995, Joined Cases C-358/93 and C-416/93, *Criminal proceedings against Aldo Bordessa, Vicente Marí Mellado and Concepción Barbero Maestre* [1995] ECR I-361, Paras. 17 and 33. For a discussion of this topic, see S. Mohamed, "Legal and Judicial Developments in the Field of Capital Movements", *European Business Law Review* (1996), p. 273 et seq.
- 6. For example, ECJ, 19 January 1982, Case 8/81, Ursula Becker v. Finanzamt Münster-Innenstadt [1982] ECR 53, Para. 17 et seq.
- Art. 6 Directive 88/361/EEC.
- 8. ECJ, 6 June 2000, Case C-35/98, *Staatssecretaris van Financiën v. B.G.M. Verkooijen* [2000] ECR I-4071, Para. 32 et seq.
- 9. Art. 73a EC Treaty. It should also be noted that a number of bilateral, or even multilateral, treaties concluded by the European Union deal with capital movements. In this respect, see the Commission's report on Provisions on Capital Movements in multilateral and bilateral agreements of the European Union with third parties, (Brussels, May 2005). Depending on the individual nature of the agreement, this may form an "integral part" of the Community legal order. See, in particular, "mixed agreements". See also 2.2.1.
- 10. All of the cases, in principle, concerned the same Spanish legislation that made the export of Spanish pesetas or foreign currencies subject to either a prior declaration or even to prior administrative authorization. It was, however, the nationality and the place of residence of the individuals involved, as well as the particular border concerned, that varied from case to case. The *Bordessa* judgment concerned an Italian citizen, residing in Italy (C-358/93) and two Spanish citizens residing in Spain (C-416/93), all crossing the border between Spain and France. The *Sanz de Lera* decision, however, dealt with a Spanish citizen residing in Spain who was driving through France to Switzerland (C-163/94), a Spanish citizen residing in the United Kingdom who was flying from Spain via Switzerland to the United Kingdom (C-165/94) and a Turkish citizen residing in Spain who was flying from Spain to Turkey (C-250/94).
- 11. ECJ, 14 December 1995, Joined Cases C-163/94, C-165/94 and C-250/94, Criminal proceedings against Lucas Emilio Sanz de Lera, Raimundo Díaz Jiménez and Figen Kapanoglu [1995] ECR I-4821, Para. 19.
- 12. Compare A. Cordewener, Europäische Grundfreiheiten und nationales Steuerrecht (Cologne: Otto Schmidt, 2002), pp. 103 et seq., 200 et seq., 249 et seq. and 322 et seq. and A. Cordewener, "The prohibitions of discrimination and restriction within the framework of the fully integrated market", in F. Vanistendael (ed.), EU Freedoms and Taxation (Amsterdam: IBFD, 2006), p. 7 et seq. For a closer analysis of the effects of the free movement of capital on taxation in situations between Member States, see A. Dourado, "Free movement of Capital and Capital Income Taxation within the European Union", EC Tax Review (1994), p. 176 et seq.; P. Bentley, "Tax obstacles to the free movement of capital", EC Tax Journal (1996/97), p. 49 et seq.; J. Usher, "Tax discrimination under the new capital movement provisions and the basic Treaty freedoms", in M. Rudanko and P. Timonen (eds.), European Financial Area (Helsinki: Helsinki University Institute of International Economic Law, 1997), p. 259 et seq.; W. Schön, "Europäische Kapitalverkehrsfreiheit und nationales Steuerrecht", in W. Schön (ed.), Gedächtnisschrift für B. Knobbe-Keuk (Cologne: Otto Schmidt, 1997), p. 743 et seq.; and M. Peters, "Capital movements and taxation in the EC", EC Tax Review (1998), p. 4 et seq.
- 13. See, for example, ECJ, 16 March 1999, Case C-222/97, Manfred Trummer and Peter Mayer [1999] ECR I-1661; ECJ, 1 June 1999, Case C-302/97, Klaus Konle v. Republic of Austria [1999] ECR I-3099; ECJ, 14 October 1999, Case C-439/97, Sandoz GmbH v. Finanzlandesdirektion für Wien, Niederösterreich und Burgenland [1999] ECR I-7041; ECJ, 14 March 2000, Case C-54/99, Association Eglise de Scientologie de Paris, Scientology International Reserves Trust v. The Prime Minister [2000] ECR I-1335; ECJ, 11 January 2001, Case C-464/98, Westdeutsche Landesbank Girozentrale v. Friedrich Stefan [2001] ECR I-173; ECJ, 2 June 2005, Case C-174/04, Commission of the European Communities v. Italian Republic [2005] ECR I-4933; and ECJ, 28 September 2006, Joined Cases C-282/04 and C-283/04, Commission of the European Communities v. Kingdom of the Netherlands, not yet reported, with further references concerning the "Golden Shares" case law. For a survey, see L. Flynn, "Coming of age: The free movement of capital case law 1993-2002", 39 Common Market Law Review (2002), p. 773 et seq.
- 14. See ECJ, 26 September 2000, Case C-478/98, Commission of the European Communities v. Kingdom of Belgium [2000] ECR I-7587; ECJ, 21 November 2002, Case C-436/00, X, Y v. Riksskatteverket [2002] ECR I-10829, Para. 66 et seq.; ECJ, 4 March 2004, Case C-334/02, Commission of the European Communities v. French Republic [2004] ECR I-2229, Para. 24 et seq.; ECJ, 8 June 2004, Case C-268/03, Jean-Claude De Baeck v. Belgian State [2004] ECR I-5961; ECJ, 5 July 2004, Case C-315/02, Anneliese Lenz v. Finanzlandesdirektion für Tirol [2004] ECR I-7063; ECJ, 15 July 2004, Case C-242/03, Ministre des Finances v. Jean-Claude Weidert, Élisabeth Paulus [2004] ECR I-7379; ECJ, 7 September 2004, Case C-319/02, Petri Manninen [2004] ECR I-7477; ECJ, 5 July 2005,

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within the European Union, the EC Treaty objective of "an internal market characterized by the abolition between Member States of obstacles to the free movement of goods, persons, services and capital" is pursued in a uniform and homogeneous manner.

Astonishing, however, is the fact that, for almost a decade, the third country perspective was widely neglected, even though the ECJ had clearly opened that door in Sanz de Lera. Until recently, neither outside nor within the direct tax sector have any relevant cases been decided by the ECJ. Still, it has been obvious for some time that an increasing number of cases are being brought before the domestic courts of various Member States, remembering that the cases reaching the ECJ can only be regarded as the tip of the iceberg. It is, in particular, the area of direct taxation in which a considerable number of cases are now pending before the ECJ and where the Court has started to discover the unknown realms of third country relationships. Many of these cases carry problems across the European Union's external borders on which the ECJ has already ruled in an intra-EU context,16 whereas others arrive at the Court for the first time, but immediately cover both intra-EU and third country relationships.¹⁷

Based on the foregoing, this article provides a survey of the dogmatic and practical issues that have been raised in legal doctrine and by the ECJ with regard to Art. 56 to Art. 58 of the EC Treaty and their relevance to capital movements between Member States and third countries.

2. Scope of Application of Art. 56(1) in Third Country Relationships

2.1. Introductory remarks

Whilst the *temporal* scope of application of Art. 56(1) of the EC Treaty has not yet raised specific problems, 18 the primary issue to be resolved is the substantial scope of the application of Art. 56(1) regarding the protection of movements of capital between Member States and third countries. Art. 56(1) of the EC Treaty states that "all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited" (emphasis added). Two limitations follow this basic principle of free movement, i.e. a grandfather clause relating to third country-directed restrictions¹⁹ and an exceptions clause.²⁰ Art. 59 and Art. 60 of the EC Treaty also state that the free movement of capital in relation to third countries may be subjected to restrictions.²¹ As for the *personal* scope of Art. 56(1) of the EC Treaty, the persons invoking the free movement of capital need not be nationals of a Member State. Whilst the old Art. 67 of the EEC Treaty had merely required residence in, not nationality of, a Member State, the text of Art. 56 of the EC Treaty is even wider, referring only to the movement of capital between Member States. This breadth can be seen in cases such as *Svensson* and Gustavsson²² and Bordessa,²³ in both of which citizens of third countries invoked this freedom. Finally, the most interesting and unique feature of Art. 56 of the EC Treaty is its extra-community dimension, as, according Case C-376/03, D. v. Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen [2005] ECR I-5821; ECJ, 8 September 2005, Case C-512/03, J.E.J. Blanckaert v. Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen [2005] ECR I-7685; ECJ, 19 January 2006, Case C-265/04, Margaretha Bouanich v. Skatteverket [2006] ECR I-923; ECJ, 14 September 2006, Case C-386/04, Centro di Musicologia Walter Stauffer v. Finanzamt München für Körperschaften, not yet reported; and ECJ, 14 November 2006, Case C-513/04, Mark Kerckhaert, Bernadette Morres v. Belgian State, not yet reported.

15. Art. 3(1) lit. c EC Treaty.

16. See, for instance, first, with regard to the German thin capitalization rules ECJ, 12 December 2002, Case C-324/00, *Lankhorst-Hohorst GmbH v. Finanzamt Steinfurt* [2002] ECR I-11779, concerning the freedom of establishment between Germany and the Netherlands, and, second, ECJ, Pending Case C-492/04, *Lasertec Gesellschaft für Stanzformen mbH (formerly Riess Laser Bandstahlschnitte GmbH) v. Finanzamt Emmendingen*, Official Journal, 2005, C 31/11, concerning the free movement of capital between Germany and Switzerland. After ECJ, 18 September 2003, Case C-168/01, *Bosal Holding BV v. Staatssecretaris van Financiën* [2003] ECR I-9409, concerning Art. 43 of the EC Treaty and the Netherlands rules on cost deductions in connection with the affiliation privilege for participations in EU-subsidiaries, various cases are still pending before the Netherlands courts with regard to non-EU subsidiaries and the effect of Art. 56(1) of the EC Treaty.

17. This is, in particular, applies to a number of UK group litigation cases. See, for example, ECJ, 12 December 2006, Case C-374/04, Test Claimants in Class IV of the ACT Group Litigation v. Commissioners of Inland Revenue, not yet reported, and ECJ, 12 December 2006, Case C-446/04, Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue, not yet reported. In addition, see ECJ, Advocate General Geelhoed's Opinion, 29 June 2006, Case C-524/04, Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue, not yet reported, and ECJ, Pending Case C-201/05, The Test Claimants in the CFC and Dividend Group Litigation v. Commissioners of Inland Revenue, Official Journal, 2005, C 182/27. See, in general, also S. Whitehead, "The Next Round - Third Countries and the EU", The Tax Journal (23 May 2005), p. 9 et seq. Compare furthermore, ECJ, Pending Case C-414/06, Lidl Belgium GmbH & Co. KG (or M + T) v. Finanzamt Heilbronn, Official Journal, 2006, C 326/26 and ECJ, Pending Case C-415/06, Stahlwerk Ergste Westig GmbH v. Finanzamt Düsseldorf-Mettmann, Official Journal, 2006, C 326/26, both concerning the treaty "exemption" of foreign PE losses under German tax treaties, but the first case covering a situation between Germany and Luxemburg and the second case one between Germany and the United States. See finally, for a "third-country dimension", ECJ, Pending Case C-194/06, Staatssecretaris van Financiën v. Orange European Smallcap Fund NV, Official Journal, 2006, L 178/15.

18. See 1. It should, however, be appreciated that the ECJ implicitly acknowledges that investments made before 1 July 1990 or 1 January 1994, respectively, also enjoy protection under the Directive 88/361/EEC or Art. 56(1) of the EC Treaty, respectively. After these dates; these investments "grow" into Community law protection. See implicitly, for example, ECJ, 23 February 2006, Case C-471/04, Finanzamt Offenbach am Main-Land v. Keller Holding GmbH [2006] ECR I-2107 (concerning an Austrian subsidiary of a German company and taxable years before and after Austria's accession to the European Union) and ECI, 12 December 2006, Case C-446/04, Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue, not yet reported (concerning dividend payments dating back to the 1970s). Some specific, though mostly irrelevant (see 3. and also ECJ, 6 June 2000, Case C-35/98, Staatssecretaris van Financiën v. B.G.M. Verkooijen [2000] ECR I-4071, Para. 38), timing issues for intra-EU situations surround Art. 58 (1) lit. a of the EC Treaty, as it had been agreed in Declaration No. 7 annexed to the Maastricht Treaty that this provision applies only in respect of national tax law provisions that existed at the end of 1993, and only insofar as capital movements between Member States are concerned. Annex IV of the 2003 Act of Accession, Official Journal, 2003, L 236/33, 797, also contains a specific provision for Estonia to apply Art. 58(1) lit. a of the EC Treaty to provisions that existed on 31 December 1999 and affect capital movements between Member States, whereas as a general rule for the other acceding Member States at the end of 1993 is decisive.

- 19. Art. 57 EC Treaty. See 4.
- 20. Art. 58 EC Treaty. See 3
- 21. See, for example, ECJ, Advocate General Geelhoed's Opinion, 10 April 2003, Case C-452/01, Margarethe Ospelt and Schlössle Weissenberg Familienstiftung [2003] ECR I-9743, Para. 35.
- 22. ECJ, 14 November 1995, Case C-484/93, Peter Svensson and Lena Gustavsson v. Ministre du Logement et de l'Urbanisme [1995] ECR I-3955.
- 23. ECJ, 23 February 1995, Joined Cases C-358/93 and C-416/93, Criminal proceedings against Aldo Bordessa, Vicente Marí Mellado and Concepción Barbero Maestre [1995] ECR I-361.

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to its wording, it appears to cover third country elements without limitation. It also extends to capital movements into and out of the Community, as well as within it. Whilst, however, Art. 56(1) of the EC Treaty deals with external capital movements in the same broad terms that are used for intra-Community capital movements, the existence of Art. 57, Art. 59 and Art. 60 clearly creates a less liberalized framework.

As can be derived from the wording of Art. 56(1) of the EC Treaty (see 1.), the mere language of the provision does not distinguish between the prohibition of restrictions on the movement of capital "between Member States", on the one hand, and "between Member States and third countries", on the other. This remarkable feature of Art. 56(1) of the EC Treaty, which appears to grant identical protection to scenarios involving third countries compared to situations of capital movements within the European Union, has already been noted by many authors.²⁴ Likewise, Art. 58(1) of the EC Treaty, which grants a number of exceptions to Art. 56, in particular in respect of the field of taxation, does not differentiate between places of residence or places of investment within the European Union and in third countries.²⁵ Taken literally, cross-border capital investments between Member States and third countries, therefore, appear to enjoy full protection under the EC Treaty, especially regarding tax matters. Accordingly, a large number of decisions of national courts can be identified that, without referring questions for further clarification to the ECJ, did not hesitate to extend the substantive scope of Art. 56(1) of the EC Treaty to third country scenarios. These decisions, which are generally without limitation at this stage,²⁶ assume that EC law protection is available both in "outbound" situations, i.e. investment from the European Union in a third country,²⁷ and in "inbound" situations, i.e. investment from a third country in the European Union.²⁸

With reference to the telos and the systematic context of Art. 56(1) of the EC Treaty, some authors, however, question whether or not this provision should be interpreted in such a broad way. Initially, differences between cases involving Member States only and those involving third countries can be identified. One difference is the missing reciprocity in the third country context.²⁹ Another is the lack of a common objective corresponding to the establishment of the Single Market.³⁰ It has, therefore, been argued that the purpose of the free movement of capital in respect of third countries is without doubt more limited.31 Similarly, the lack of harmonizing powers of the EU institutions outside the Community leads to a substantially different starting point. The absence of this objective to achieve a Single Market in the third country makes it tempting to choose a rather narrow interpretation. Accordingly, one author has suggested that the rationale behind the inclusion of third country scenarios in the free movement of capital is merely to ensure uniform borders to non-EU territories.³² In other words, both entrance to and exit out of the European Union should be governed by the same principles. Accordingly, the provisions to and from third countries should be interpreted in the light of their own purpose, which may differ from the one established regarding capital movements between Member States.³³ Against this general background several attempts to limit the substantive scope of Art. 56(1) of the EC Treaty are possible.

2.2. Potential delimitation of the substantive scope of application of Art. 56(1)

2.2.1. No direct application in third country relationships?

A rather drastic approach would be to deny the direct application of Art. 56(1) of the EC Treaty in situations "between Member States and third countries". This approach could find its theoretical basis in the ECJ's jurisprudence on bilateral or "mixed agreements" with non-Member States, in respect of which the Court has stated that:

It is clear from that case-law that the extension of the interpretation of a provision in the Treaty to a comparably, similarly or even identically worded provision of an agreement concluded by the Community with a non-member country depends, *inter alia*, on the aim pursued by each provision in its particular context and that a comparison between the objectives and context of the agreement and those of the Treaty is of considerable importance in that regard.

- 24. See for instance K. Ståhl, "Free movement of capital between Member States and third countries", EC Tax Review (2004), p. 50; W. Schön, "Der Kapitalverkehr mit Drittstaaten und das internationale Steuerrecht", in R. Gocke, D. Gosch and M. Lang (eds.), Körperschaftsteuer Internationales Steuerrecht Doppelbesteuerung, Festschrift für F. Wassermeyer (Munich: C.H. Beck, 2005), p. 492; and A. Schnitger, "Die Kapitalverkehrsfreiheit im Verhältnis zu Drittstaaten Vorabentscheidungsersuchen in den Rs. van Hilten, Fidium Finanz AG und Lasertec", Internationales Steuerrecht (2005), p. 493.
- 25. Ståhl, note 24. See also ECJ, 14 December 1995, Joined Cases C-163/94, C-165/94 and C-250/94, Criminal proceedings against Lucas Emilio Sanz de Lera, Raimundo Díaz Jiménez and Figen Kapanoglu [1995] ECR I-4821.
- 26. It should be noted that this discussion concerns the scope of the application of the prohibition in Art. 56(1) of the EC Treaty. Most of the ECJ decisions referred to here, in fact, tried to reduce the effect of the free movement of capital at a later stage, i.e. either at the level of Art. 58 (see 3.) or at the level of Art. 57(1) (see 4.) of the EC Treaty.
- 27. See, for example, for Austria, Tax Court (Unabhängiger Finanzsenat) of Linz, 13 January 2005, RV/0279-L/04, regarding portfolio dividends from, inter alia, Switzerland and the United States. (For comment see G. Kofler and G. Toifl, "Austria's Differential Treatment of Domestic and Foreign Intercompany Dividends Infringes the EU's Free Movement of Capital", 45 European Taxation 6 (2005), p. 232 et seq.) For Germany, see Tax Court (Finanzgericht) Hamburg, 9 March 2004, VI 279/01, Entscheidungen der Finanzgerichte (2004), p. 1575 (Germany-Switzerland); Finanzgericht Düsseldorf, 14 September 2004, 6 K 3796/01 K, F, Entscheidungen der Finanzgerichte (2005), p. 540 (Germany-United States); Finanzgericht of Hessen, 2 March 2005, 4 K 3876/01, Entscheidungen der Finanzgerichte (2006), p. 1209 (Germany-Switzerland); Federal Tax Court (Bundesfinanzhof), 14 September 2005, VIII B 40/05, Internationales Steuerrecht (2006), p. 180 (Germany-Switzerland); Finanzgericht Munich, 25 October 2005, 6 K 4796/03, Entscheidungen der Finanzgerichte 2006, p. 421; Bundesfinanzhof, 21 December 2005, I R 4/05, Internationales Steuerrecht (2006), p. 459 (Germany-Switzerland); Bundesfinanzhof, 22 February 2006, I R 120/04, Bundessteuerblatt 2006, Part II, p. 864 et seq. (Germany-United States); and Bundesfinanzhof, 9 August 2006, I R 95/05, Betriebs-Berater (2006), p. 2565 et seq. (Germany–South Africa).
- 28. With regard to Germany, see, for example, *Bundesfinanzhof*, 26 May 2004, I R 54/03, *Bundessteuerblatt* 2004, Part II, p. 770 (Russia–Germany).
- 9. Ståhl, note 24, p. 51; Schön, note 24, p. 503; and Schnitger, note 24.
- 30. The same is true for the objective of a functioning Monetary Union. See, for example, C. Peters and J. Gooijer, "The Free Movement of Capital and Third Countries: Some Observations", 45 *European Taxation* 11 (2005), p. 476.
- 31. Ståhl, note 24, p. 50.32. Schön, note 24, p. 506.
- 33. Ståhl, note 24, p. 52 et seq.

In this respect, referring to Art. 31 of the Vienna Convention of 23 May 1969 on the Law of Treaties, the ECJ requires that provisions in an agreement must not only be unconditional and sufficiently precise, but must also be interpreted in good faith in accordance with their ordinary meaning in their context and in the light of their object and purpose.³⁴ It could, in fact, be argued that the same cautious approach should, a fortiori, apply to Art. 56(1) of the EC Treaty in relation to third countries, as this provision does not even form part of a bilateral agreement with mutual obligations, but is, instead, only a *unilateral* (self-imposed) obligation on the Member States.

Yet, it appears difficult to maintain such a distinction between the two clauses in Art. 56(1) of the EC Treaty regarding capital movements "between Member States", on the one hand, and those "between Member States and third countries", on the other. Not only the wording but also the context of the provision puts the obligations prescribed by both clauses on equal footing. In addition, it is obvious that the Member States enforced their own obligations towards third countries by introducing the second clause directly into the EC Treaty. This stands in a clear contrast to the previous situation, in which Art. 70 of the EEC Treaty only provided for "Council measures for the progressive coordination of the exchange policies of Member States in respect of the movement of capital between those States and third countries" and where Art. 7(1) of Directive 88/361/EEC merely contained a non-binding declaration of intent to liberalize third country relations.³⁵ In fact, it must be noted that the ECJ did not only refuse to pay attention to the considerations previously referred to in its early Sanz de *Lera*³⁶ decision, but also completely avoided the issue in its recent judgments in Van Hilten-van der Heijden³⁷ and FII Group Litigation.³⁸ In particular in the latter two cases, the ECJ was concerned with the questions of whether or not there was a restriction and whether or not Art. 57(1) and Art. 58 of the EC Treaty could be relied on. This results in the conclusion that implicitly the full direct application of Art. 56(1) of the EC Treaty in third country relationships was accepted by the ECJ. Along these lines, the ECJ has now made its position clear in the FII Group Litigation judgment and has held that, outside Art. 57(1) of the EC Treaty,

a restriction on capital movements prohibited by Article 56 EC could not be applied, even in relations with non-member countries.³⁹

This broad wording and the ECJ's indifference toward protection of "capital movements to or from non-member countries" ⁴⁰ also strongly implies a rejection of the idea of a *partial* denial of the direct application of Art. 56 of the EC Treaty, insofar as the relevant movement of capital concerns an inbound activity from a third country to a Member State. ⁴¹

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2.2.2. Partial reduction of the substantive scope of application in third country relationships?

Even if the direct application of Art. 56(1) of the EC Treaty to capital movements involving non-Member States is, in principle, accepted by most authors, there is still a whole range of approaches to reduce the broad scope of the provision. One approach could be to limit its *subjective* scope of application to citizens or residents of a Member State, taking the narrow view that only the latter should enjoy the privileges granted by the EC Treaty and its fundamental freedoms.⁴² In addition to the fact that Art. 56(1) of the EC Treaty neither requires citizenship nor residence as an EU nexus, the free movement of capital covers both the investor and the investee. 43 Accordingly, there should always be (at least) one party to the transaction resident in the European Union. Consequently, this limitation would not have material consequences. Most authors, however, deny such a limitation of the personal scope of Art. 56 of the EC Treaty a *limine*, 44 and case law also clearly suggests the opposite. 45

34. See ECJ, 1 July 1993, Case C-312/91, Procedural issue relating to a seizure of goods belonging to Metalsa Srl [1993] ECR I-3751, Para. 10 et seq., regarding the free trade agreement concluded with Austria in 1972. Compare also ECJ, 5 July 1994, Case C-432/92, The Queen v. Minister of Agriculture, Fisheries and Food, ex parte S. P. Anastasiou (Pissouri) Ltd and others [1994] ECR I-3087, Para. 23, regarding the free trade agreement concluded with Cyprus in 1972.

- 35. This provision read as follows: "In their treatment of transfers in respect of movements of capital to or from third countries, the Member States shall endeavour to attain the same degree of liberalisation as that which applies to operations with residents of other Member States, subject to the other provisions of this Directive. The provisions of the preceding subparagraph shall not prejudice the application to third countries of domestic rules or Community law, particularly any reciprocal conditions, concerning operations involving establishment, the provisions of financial services and the admission of securities to capital markets".
- 36. ECJ, 14 December 1995, Joined Cases C-163/94, C-165/94 and C-250/94, Criminal proceedings against Lucas Emilio Sanz de Lera, Raimundo Díaz Jiménez and Figen Kapanoglu [1995] ECR I-4821, Para. 44 et seq.
- 37. ECJ, 23 February 2006, Case C-513/03, Heirs of M.E.A. van Hilten-van der Heijden v. Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen, not yet reported, Para. 37 et seq.
- 38. ECJ, 12 December 2006, Case C-446/04, Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue, not yet reported, Paras. 169 et seq. and 174 et seq.
- 39. Id., Para. 186 and also implicitly Para. 165 et seq.
- 40. Id., Para. 183.
- 41. For arguments supporting this, see Schön, note 24, p. 496.
- 42. It has, in fact, been suggested quite generally by German authors that all the fundamental freedoms should be restricted in their personal scope and only open to EU citizens. See T. Kingreen and R. Störmer, "Die subjektivöffentlichen Rechte des primären Gemeinschaftsrechts", Europarecht (1998), p. 274 et seq. and T. Kingreen, Die Struktur der Grundfreiheiten des Europäischen Gemeinschaftsrechts (Berlin: Duncker & Humblot, 1999), p. 78 et seq. This would mean that, even with regard to pure intra-EU situations, Art. 56(1) of the EC Treaty could never be invoked by non-EU nationals.
- 43. ECJ, 6 June 2000, Case C-35/98, Staatssecretaris van Financiën v. B.G.M. Verkooijen [2000] ECR I-4071, Para. 34 et seq. and ECJ, 26 September 2000, Case C-478/98, Commission of the European Communities v. Kingdom of Belgium [2000] ECR I-7587, Para. 18. See also ECJ, Advocate General Kokott's Opinion, 12 February 2004, Case C-242/03, Ministre des Finances v. Jean-Claude Weidert and Élisabeth Paulus [2004] ECR I-7379, Para. 21 et seq. 44. Ståhl, note 24, p. 47.
- 45. ECJ, 12 December 2006, Case C-446/04, Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue, not yet reported, Para. 186. See also ECJ, 14 November 1995, Case C-484/93, Peter Svensson and Lena Gustavsson v. Ministre du Logement et de l'Urbanisme [1995] ECR I-3955, Para. 6 et seq. and ECJ, 14 December 1995, Joined Cases C-163/94, C-165/94 and C-250/94, Criminal proceedings against Lucas Emilio Sanz de Lera, Raimundo Díaz Jiménez and Figen Kapanoglu [1995] ECR I-4821.

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Another approach to limit the effects of Art. 56(1) of the EC Treaty on capital movements in relation to third countries focuses on the *objective* scope of application. The argument is that only the technical (or even physical) cross-border transfer of capital should enjoy protection and that only those national measures should be caught by the prohibition that specifically catches such transfers with an effect equivalent to customs duties, whereas ordinary income or property taxes levied on the earnings or the substance of capital once invested should not be caught. 46 It has also been suggested that, in third country settings, tax provisions should be completely removed from the scope of the free movement of capital.⁴⁷ This reasoning is, however, neither shared by several national courts⁴⁸ nor the prevailing opinion in legal scholarship. 49 The ECJ has not only rejected these contentions in the recent FII Group Litigation case, but has also extended the broad substantial scope of Art. 56 of the EC Treaty as developed in its prior case law on intra-EU situations to third country situations. This conclusion is strongly implied by the ECJ's discussion of Art. 57(1) of the EC Treaty, as

the restrictions on capital movements involving direct investment or establishment within the meaning of Article 57(1) EC extend not only to national measures which, in their application to capital movements to or from non-member countries, restrict investment or establishment, but also to those measures which restrict payments of dividends deriving from them.⁵⁰

Recently, however, another potential limitation on the scope of Art. 56(1) of the EC Treaty has attracted attention. This development is all the more surprising, as it is not specifically linked with the general teleological arguments advanced to reduce a potential erga omnes effect of this provision. Instead, such a reduction could simply result from a mere non-application of the free movement of capital in situations simultaneously covered by another fundamental freedom. The concept behind this limitation is that the scope of a fundamental freedom, for example the freedom of establishment, that does not cover third country scenarios should not be "extended" beyond Community borders via the application of the free movement of capital. Whether or not the various fundamental freedoms can complement each other is a tricky question. It is fair to say that, in legal writing, a whole scale of opinions, ranging from the "exclusivity approach" to the "effet utile approach" can be observed. According to the latter, which appears to be predominant,⁵¹ several freedoms can apply to a single case simultaneously. On this basis, various national courts and scholars have suggested that such complementary protection under the free movement of capital will become exclusive in third country situations if a specific economic activity would, in substance, also be covered by, for example, the freedom of establishment, which, however, does not apply for territorial reasons in the case in question.⁵² Accordingly, Art. 56 of the EC Treaty has been invoked not only to counter discriminations of inbound dividends flowing from majority investments in third country companies,53 but also regarding the loss utilization of foreign permanent establishments (PE)⁵⁴ or the *Bosal* type deductibility of financing costs of third country subsidiaries.⁵⁵ Recently, however, first sources suggest that the pendulum has swung back.⁵⁶ Both the older jurisprudence of the ECJ and the opinions of various Advocates General lack a consistent approach.⁵⁷ Nevertheless, lately and along the lines already suggested by Advocate General Alber's Opinion in *Baars*,⁵⁸ the ECJ has tended to create a system of priority amongst the fundamental freedoms, depending on the national measure in question and its effects on the freedoms potentially affected, i.e.:

Where a national measure relates to the freedom to provide services and the free movement of capital at the same time, it is necessary to consider to what extent the exercise of those fundamental liberties is affected and whether, in the circumstances of

- 46. Schön, note 24, p. 502 et seq. Some authors even limit this to the physical transfer. See S. Mohamed, European Community Law on the Free Movement of Capital and the EMU (The Hague/London/Boston/Stockholm: Kluwer, 1999), p. 217.
- 47. Dissenting and with further references, see Ståhl, note 24, p. 54 et seq. See notes 27 and 28. See also Verwaltungsgerichtshof, 28 January 2005,

- 2004/15/0105, ecolex 2005/253 with comments by P. Plansky.
 49. For recent comments see D. Hohenwarter, "Vorlagebeschluss des VwGH zur Kapitalverkehrsfreiheit im Verhältnis zu Drittstaaten", Steuer und Wirtschaft International (2005), p. 225 et seq.; C. Staringer, "Pending Cases Filed by Austrian Courts: The Holböck Case", in M. Lang, J. Schuch and C. Staringer (eds.), ECJ - Recent Developments in Direct Taxation (Vienna: Linde, 2006), pp. 9 and 11 et seq.; Schnitger, note 24; R. Obser, "§ 8a KStG im Inbound-Sachverhalt - eine EG-rechtliche Beurteilung", Internationales Steuerrecht (2005), p. 802 et seq.; and J. Schönfeld and B. Lieber, "Swedish CFC-Rules under Scrutiny of EC Law: Harmful Tax Competition and the Free Movement of Capital in Relation to Third Countries", Intertax (2006), p. 99 et seq.
- ECJ, 12 December 2006, Case C-446/04, Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue, not yet reported, Para. 183.
- See J. Englisch, Dividendenbesteuerung (Cologne: Schmidt, 2005), p. 219; Schön, note 24, p. 498 et seq.; Kofler and Toifl, note 27, p. 233 et seq.; J. Schönfeld, Hinzurechnungsbesteuerung und Europäisches Gemeinschaftsrecht (Cologne: Schmidt, 2005), p. 275 et seq. with further references; and A. Rust, Reform der Hinzurechnungsbesteuerung (Munich: C.H. Beck, forthcoming). In this respect, see also the Commission's Communication on certain legal aspects of investment in the European Union, Official Journal, 1997, C 220/15, Paras. 3 and 4, and the survey of the ECJ's case law provided by A. Landsmeer, "Movement of Capital and Other Freedoms", Legal Issues of Economic Integration (2001/1), p. 57 et seq.
- 52. See Schön, note 24, p. 500 et seq.; Hohenwarter, note 49, p. 227; Schnitger, note 24, p. 503; and Staringer, note 49, p. 18.
- 53. See Verwaltungsgerichtshof, 28 January 2005, 2004/15/0105, currently before the ECJ as Pending Case C-157/05, Winfried L. Holböck v. Finanzamt Salzburg-Land, Official Journal, 2005, C 143/26. For details on this case see Hohenwarter, note 49 and Staringer, note 49, p. 9 et seq.
- 54. Bundesfinanzhof, 22 August 2006, R 116/04, Bundessteuerblatt, Part II (2006), p. 864 et seq., currently before the ECJ as Pending Case C-415/06, Stahlwerk Ergste Westig GmbH v. Finanzamt Düsseldorf-Mettmann, Official Journal, 2006, C 326/26. For a first discussion of the request, see M. Schwenke, "Anmerkungen zum Vorlagebeschluss des BFH an den EuGH vom 22. August 2006 - IR 116/04", Internationales Steuerrecht (2006), p. 818 et seq.
- 55. See Bundesfinanzhof, 9 August 2006, I R 95/05, Betriebs-Berater (2006), p. 2565 et seq. with annotations by K. Prokopf, in which the Bundesfinanzhof decided the issue in favour of the taxpayer without request of a preliminary ruling. For details on this case, see H. Rehm and J. Nagler, "Verbietet die Kapitalverkehrsfreiheit nach 1993 eingeführte Ausländerungleichbehandlung?", Internationales Steuerrecht (2006), p. 861.
- 56. M. Schwenke, "Die Kapitalverkehrsfreiheit im Wandel?", Internationales Steuerrecht (2006), p. 752 et seq. and Schwenke, note 54, p. 820. See also ECJ, Advocate General Geelhoed's Opinion, 23 February 2006, Case C-374/04, Test Claimants in Class IV of the ACT Group Litigation (Pirelli, Essilor and Sony) Test Claimants in Class IV of the ACT Group Litigation (BMW) v. Commissioners of Inland Revenue, not yet reported, Para. 28 et seq.
- 57. For an overview, see ECJ, Advocate General Stix-Hackl's Opinion, 16 March 2006, Case C-452/04, Fidium Finanz AG v. Bundesanstalt für Finanzdienstleistungsaufsicht, not yet reported, Para. 41 et seq.
- 58. ECJ, Advocate General Alber's Opinion, 14 October 1999, Case C-251/98, C. Baars v. Inspecteur der Belastingen/Ondernemingen Gorinchem [2000] ECR I-2787, Para. 26 et seq.

112 | EUROPEAN TAXATION MARCH 2007 © IBFD the main proceedings, one of those prevails over the other ... The Court will in principle examine the measure in dispute in relation to only one of those two freedoms if it appears, in the circumstances of the case, that one of them is entirely secondary in relation to the other and may be considered together with it ...⁵⁹

In the non-tax Fidium Finanz⁶⁰ case, which concerned the provision of financial services by a third country service provider, the ECJ acknowledged that both the freedom to provide services and the free movement of capital were affected by the national measure at issue. The ECJ, however, regarded the former freedom, which does not extend protection to third country citizens, as "primarily" affected and, therefore, did not enter into a discussion as to whether or not the third country situation was protected by Art. 56 of the EC Treaty. In the tax area, there has been a recent focus on tax issues related to third country subsidiaries and, therefore, on the question of whether or not protection under Art. 56 of the EC Treaty is available if such investment would, but for its territorial aspect, be protected under Art. 43 and Art. 48. In this respect, Cadbury Schweppes⁶¹ implies that the ECJ gives primary weight to the freedom of establishment and would, therefore, not allow protection under Art. 56 of the EC Treaty if, for example, domestic controlled foreign companies (CFC) rules target third country subsidiaries, i.e.:

In this case, the legislation on CFCs concerns the taxation, under certain conditions, of the profits of subsidiaries established outside the United Kingdom in which a resident company has a controlling holding. It must therefore be examined in the light of Articles 43 EC and 48 EC. ... If, as submitted by the applicants in the main proceedings and Ireland, that legislation has restrictive effects on the free movement of services and the free movement of capital, such effects are an unavoidable consequence of any restriction on freedom of establishment and do not justify, in any event, an independent examination of that legislation in the light of Articles 49 EC and 56 EC ... 62

The FII Group Litigation case is, however, less clear in this respect. Whilst parts of the judgment appear to imply that application of the freedom of establishment and the free movement of capital are mutually exclusive in respect of the taxation of inbound-dividend flows from foreign companies, depending on the degree of participation in the foreign company,⁶³ other parts of the judgment appear to suggest that discriminatory taxation of dividends from third country subsidiaries could infringe Art. 56 of the EC Treaty.⁶⁴

Given this tendency in *Fidium Finanz* and *Cadbury Schweppes* to differentiate according to which fundamental freedom is "primarily" affected, it could be wondered how Art. 57(1) of the EC Treaty would fit in. This provision grandfathers third country restrictions that existed by the end of 1993 and were adopted

in respect of the movement of capital to or from third countries involving direct investment – including in real estate – establishment, the provision of financial services or the admission of securities to capital markets.⁶⁵

There is broad agreement that the items referred to in Art. 57(1) of the EC Treaty generally coincide with activities that would be protected by either the freedom of establishment or the freedom to provide services in

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intra-EU settings.66 Accordingly, the financial services in question in the Fidium Finanz case constitute the "provision of financial services" within the meaning of Art. 57(1) of the EC Treaty⁶⁷ and the creation of or investment in a third country corporation at issue in *Cadbury* Schweppes and FII Group Litigation falls within the meaning of "direct investment", as referred to in Art. 57(1).⁶⁸ If, however, such economic activities were only protected under the "primarily" applicable Art. 49 or Art. 43 and Art. 48 of the EC Treaty, respectively, and the protection did not, therefore, extend beyond Community borders, why would Art. 57(1) grandfather restrictions regarding these activities in third country settings?⁶⁹ This apparent paradox can obviously not be eliminated by a differentiated interpretation of Art. 56 of the EC Treaty, on the one hand, and Art. 57(1), on the other. In this respect, for example, Advocate General Geelhoed appears to suggest that there is some scope of direct investment under Art. 57(1) of the EC Treaty that is not simultaneously covered by the freedom of establishment under Art. 43.70 Such reasoning would, however, result in a differentiated and probably counterintuitive framework of legal protection. Whilst portfolio investments in third country corporations would be fully covered by Art. 56 of the EC Treaty, restrictions on direct investments that do not confer a definite influence over the decisions of a company or allow it to determine its activities⁷¹ could be grandfathered under Art. 57(1); conversely, investments that amount to an exercise of the freedom of establishment because they confer such

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^{59.} ECJ, 3 October 2006, Case C-452/04, Fidium Finanz AG v. Bundesanstalt für Finanzdienstleistungsaufsicht, not yet reported, Para. 34.

^{60.} ECJ, 3 October 2006, Case C-452/04, Fidium Finanz AG v. Bundesanstalt für Finanzdienstleistungsaufsicht, not yet reported.

^{61.} ECJ, 12 September 2006, Case C-196/04, Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue, not yet reported, Para. 32 et seq.

^{62.} Id.

^{63.} ECJ, 12 December 2006, Case C-446/04, *Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue*, not yet reported, Para. 33 et seq. 64. Id., Para. 165.

^{65.} See 4.

^{66.} For a recent and detailed analysis, see D. Smit, "Capital movements and third countries: the significance of the standstill-clause ex-Article 57(1) of the EC Treaty in the field of direct taxation", EC Tax Review (2006), p. 203 et seq.

^{67.} ECJ, Advocate General Stix-Hackl's Opinion, 16 March 2006, Case C-452/04, Fidium Finanz AG v. Bundesanstalt für Finanzdienstleistungsaufsicht, not yet reported, Para. 74.

^{68.} ECJ, 12 December 2006, Case C-446/04, Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue, not yet reported, Para. 177 et sea.

^{69.} ECJ, Advocate General Stix-Hackl's Opinion, 16 March 2006, Case C-452/04, Fidium Finanz AG v. Bundesanstalt für Finanzdienstleistungsaufsicht, not yet reported, Para. 74.

^{70.} ECJ, Advocate General Geelhoed's Opinion, 6 April 2006, Case C-446/04, Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue, not yet reported, Para. 119.

^{71.} For this test of application of the freedom of establishment see, for example, ECJ, 13 April 2000, Case C-251/98, C. Baars v. Inspecteur der Belastingdienst Particulieren/Ondernemingen Gorinchem [2000] ECR I-2787, Paras. 21 and 22; ECJ, 21 November 2002, Case C-436/00, X, Y v. Riksskatteverket [2002] ECR I-10829, Para. 37 and 66 to 68; ECJ, 12 September 2006, Case C-196/04, Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue, not yet reported, Para. 31; ECJ, 12 December 2006, Case C-374/04, Test Claimants in Class IV of the ACT Group Litigation v. Commissioners of Inland Revenue, not yet reported, Para. 39; and ECJ, 12 December 2006, Case C-446/04, Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue, not yet reported, Para. 58.

influence would receive no Community law protection at all, as Art. 43 and Art. 48 would take priority over Art. 56, but do not extend to third countries. This in turn poses the question of why Community law protection of a third country investment should be inversely proportional to the size of such investment.⁷²

One way to avoid this apparent paradox is to focus on the specific national measure in question. If the specific rule applies to all investments irrespective of their size, then Art. 56 of the EC Treaty would cover these restrictions regardless of whether or not Art. 43 also applied if the specific investment in question confers a definite influence over the decisions of a company or allow it to determine its activities.⁷³ Conversely, national measures that specifically envisage only situations in which the taxpayer has such an influence would only be covered by the freedom of establishment under Art. 43 of the EC Treaty. Examples of the former can be seen in cases of dividend taxation, such as Manninen⁷⁴ and FII Group Lit*igation.*⁷⁵ Examples of the latter can be seen in the cases involving CFC rules, group relief provisions or thin capitalization rules that employ a control threshold, such as in Cadbury Schweppes,⁷⁶ Marks & Spencer⁷⁷ and Test Claimants in the Thin Cap Group Litigation.⁷⁸

3. Justifications under Art. 58 in Third Country Situations

Together with the broad prohibition of restrictions on capital movements under Art. 56(1) (previously, Art. 73b(1)) of the EC Treaty, different escape clauses were inserted into the Maastricht Treaty. In this respect, Art. 58(1) (previously, Art. 73d(1)) of the EC Treaty states that:

The provisions of Article 56 shall be without prejudice to the right of Member States

- (a) to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested;
- (b) to take all requisite measures to prevent infringements of national law and regulations, in particular in the field of

Despite early comments in legal doctrine, which suggested that these clauses would seriously hamper further liberalization and deprive Art. 56(1) of the EC Treaty of any effect, 79 subsequent developments in the ECJ's judicature reveal that this is not the case. Both clauses were interpreted as essentially being a codification of case law, developed in connection with the other EC Treaty freedoms, regarding the possibility to justify restrictions on different free movement guarantees. 80 Art. 58(1) lit. b of the EC Treaty even had an explicit predecessor in Art. 4 of Directive 88/361/EEC, which had already partly been interpreted in Bordessa.81 The primary reason why Art. 58(1) of the EC Treaty does not grant the Member States *carte blanche* to act as they like in the area of taxation was that the ECJ subjected their activities to close scrutiny on the basis of Art. 58(3) (previously, Art. 73d(3)), which states that:

The measures and procedures referred to in paragraphs 1 and 2 shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 56.

The ECJ has read this provision as a specific expression of the general EC law principle of proportionality and, consequently, has set very high standards in this respect, at least when Art. 58 of the EC Treaty is applied in relation to restrictions on free movement of capital within the European Union. 82,83 In this respect, it is settled case law that unequal treatment, which places cross-border situations at a disadvantage, in order to be compatible with Art. 56(1) of the EC Treaty,

must concern situations which are not objectively comparable or [can] be justified by overriding reasons in the general interest, such as the need to safeguard the cohesion of the tax system, the fight against tax avoidance and the effectiveness of fiscal supervision [and] the difference in treatment ... [and] ... must not go beyond what is necessary in order to attain the objective of the legislation. ⁸⁴

It is, however, questionable whether or not these strict standards must also be applied to national (tax) measures restricting capital movements "between Member States and third countries".

- 72. For such a critical position, see, for example, Schön, note 24, p. 501 et seq. and Rehm and Nagler, note 55. Conversely, the question could also be raised as to whether or not Art. 58(2) of the EC Treaty could be read as preventing market participants from escaping territorial limitations of the other fundamental freedoms by evoking parallel protection under Art. 56.
- 73. See also, in this direction, J. Schönfeld, "EuGH konkretisiert Anwendung der Kapitalverkehrsfreiheit im Verhältnis zu Drittstaaten: Mögliche Konsequenzen und offene Fragen aus steuerlicher Sicht", *Der Betrieb* (2007), p. 81 et seg
- 74. ECJ, 7 September 2004, Case C-319/02, Petri Manninen [2004] ECR I-7477
- 75. ECJ, 12 December 2006, Case C-446/04, Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue, not yet reported.
- 76. ECJ, 12 September 2006, Case C-196/04, Cádbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue, not yet reported.
- 77. ECJ, 13 December 2005, Case C-446/03, Marks & Spencer plc v. David Halsey (Her Majesty's Inspector of Taxes) [2005] ECR I-10837.
- 78. See ECJ, Advocate General Geelhoed's Opinion, 29 June 2006, Case C-524/04, Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue, not yet reported.
- 79. See B. Knobbe-Keuk, "Freier Kapitalverkehr und Steuerrecht in den Maastrichter Bestimmungen ein Rückschritt", *Internationale Wirtschafts-Briefe* 18/1992 Fach 2, p. 613 et see, and A. Rädler, "Einheitlicher Europäischer Kapitalmarkt und Besteuerung", in H. Beisse, M. Lutter and H. Närgler (eds.), *Festschrift für K. Beusch* (de Gruyter: Berlin/New York, 1993), p. 686. In a similar sense, see also G. de Bont, "Taxation and the Free Movement of Capital and Payments", *EC Tax Review* (1995), p. 139 et seq.
- 80. With respect to Art. 58(1) lit. a of the EC Treaty, see ECJ, 6 June 2000, Case C-35/98, *Staatssecretaris van Financiën v. B.G.M. Verkooijen* [2000] ECR I-4071, Para. 43 et seq. As regards Art. 58(1) lit. b of the EC Treaty, see ECJ, 26 September 2000, Case C-478/98, *Commission of the European Communities v. Kingdom of Belgium* [2000] ECR I-7587, Para. 37 et seq.
- 81. ECJ, 23 February 1995, Joined Cases C-358/93 and C-416/93, Criminal proceedings against Aldo Bordessa, Vicente Marí Mellado and Concepción Barbero Maestre [1995] ECR I-361, Para. 18 et seq.
- 82. See, for example, ECJ, 21 November 2002, Case C-436/00, X and Y v. Riksskatteverket [2002] ECR I-10829.
- 83. Ståhl, note 24. p. 47.
- 84. ECJ, 15 July 2004, Case C-315/02, Anneliese Lenz v. Finanzlandesdirektion für Tirol [2004] ECR I-7063, Para. 27; ECJ, 7 September 2004, Case C-319/02, Petri Manninen [2004] ECR I-7477, Para. 29; ECJ, 8 September 2005, Case C-512/03, J.E.J. Blanckaert v. Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen [2005] ECR I-7685, Para. 42; and ECJ, 19 January 2006, Case C-265/04, Margaretha Bouanich v. Skatteverket [2006] ECR I-923, Para. 38.

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It is well established that discrimination can arise from the application of different rules to comparable situations or from the application of the same rule to different situations.⁸⁵ This definition is not limited to the unequal treatment of non-residents in "inbound" situations, but also covers unfavourable treatment of residents in cross-border "outbound" situations.86 Against this background it could be asked whether or not crossborder activities in relation to third countries are really objectively comparable to equivalent activities within Member States (or even "between Member States"). In this respect, Advocate General Kokott raised the fundamental question in Manninen87 of whether or not taxpayers in a third country scenario are in a different situation to taxpayers in a mere EU transaction. A leading scholar has also discussed the issue of whether or not the effective tax burden is to be determined on a cross-border basis. He supports this approach in the context of tax havens. Accordingly, if the tax burden in the third country is below the EU standard, the situations should be deemed to be different, so that a different treatment of those situations is permissible.88 The ECJ's position is not entirely clear. Although the ECJ has recently acknowledged that a third country investment is not necessarily comparable to a domestic one, it arrived at this conclusion with reference to the non-application of the Mutual Assistance Directive⁸⁹ in third country situations,90 i.e.:

It is true that, because of the degree of legal integration that exists between Member States of the Union, in particular by reason of the presence of Community legislation which seeks to ensure cooperation between national tax authorities, such as Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation (OJ 1977 L 336, p. 15), the taxation by a Member State of economic activities having cross-border aspects which take place within the Community is not always comparable to that of economic activities involving relations between Member States and non-member countries. ⁹¹

For several reasons, legal writing differentiates at the *level of possible justifications*. Some argue that generally the lack of reciprocity cannot lead to the requirement that the country vis-à-vis acts equally liberally. According to this opinion, it would be more convincing to decide on a case-by-case basis whether or not justifications should be interpreted differently in relation to third countries.⁹² Others, however, take a broader approach and support different grounds of justification to be the general rule.⁹³ Such an approach was also adopted by a Swedish tax court.⁹⁴ Along these lines, the ECJ recently followed Advocate General Geelhoed's approach⁹⁵ and held that

it may be that a Member State will be able to demonstrate that a restriction on capital movements to or from non-member countries is justified for a particular reason in circumstances where that reason would not constitute a valid justification for a restriction on capital movements between Member States. ⁹⁶

Again there could be recourse to the ECJ's case law regarding mixed agreements with non-Member States. In this respect, the ECJ has made it clear that, for example, the interpretation of the EC Treaty rules on the free movement of goods (Art. 28 and Art. 30, previously, Art.

30 and Art. 36 of the E(E)C Treaty) cannot be applied to similar rules in a mere free trade agreement, which does not have the purpose of establishing a Single Market. Accordingly, in the specific context of such an agreement, "restrictions on trade in goods may be considered to be justified ... in a situation in which their justification would not be possible within the Community". The ECJ supported this distinction with the argument that it was

all the more necessary inasmuch as the instruments which the Community has at its disposal in order to achieve the uniform application of Community law and the progressive abolition of legislative disparities within the Common Market have no equivalent in the context of the relations between the Community [and a particular third country]. ⁹⁷

What about the various justifications? Within the Community, the ECJ's acceptance of unwritten grounds of justification was rather limited. In accordance with settled case law, the diminution of tax receipts cannot be regarded as a matter of overriding general interest that may be relied on to justify a measure that is, in principle, contrary to a fundamental freedom. Recordingly, a simple loss of receipts suffered by a Member State because a taxpayer has moved his tax residence to another Member State cannot, in itself, justify a restriction on the right of establishment or any other freedom. Arguments related to the lack of harmonization in a certain area, compensatory effects resulting from advantages in other areas, treaty obligations, budgetary or economic policy objectives and administrative or legislative

- 85. ECJ, 14 February 1995, Case C-279/93, Finanzamt Köln-Altstadt v. Roland Schumacker [1995] ECR I-225, Para. 30 and ECJ, 11 August 1995, Case C-80/94, G.H.E.J. Wielockx v. Inspecteur der Directe Belastingen [1995] ECR I-2493, Para. 17.
- 86. See ECJ, 12 September 2002, Case C-431/01, *Philippe Mertens v. Belgian State* [2002] ECR I-7073, Para. 32.
- 87. ECJ, Advocate General Kokott's Opinion, 18 March 2004, Case C-319/02, Petri Mikael Manninen [2004] ECR I-7477, Para. 79.
- 88. Schön, note 24, p. 511 et seq.
- 89. Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation, Official Journal, 1977, L 336/15, as amended by Council Directive 2003/93/EC of 7 October 2003, Official Journal, 2003, L 264/23 and Council Directive 2004/56/EC of 21 April 2004, Official Journal, 2004, L 127/70.
- 90. It should, however, be noted that this is an argument usually employed not at the level of comparability, but, rather, at the level of the justification of discriminatory measures.
- 91. ECJ, 12 December 2006, Case C-446/04, Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue, not yet reported, Para. 170.
- 92. Schönfeld and Lieber, note 49.
- 93. See, for example, Schnitger, note 24, p. 494 with further references; Ståhl, note 24, p. 51 et seq.; and Kofler and Toifl, note 27, p. 239 et seq.
- 94. See, for example, Peters and Gooijer, note 30, p. 479.
- 95. ECJ, Advocate General Geelhoed's Opinion, 6 April 2006, Case C-446/04, Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue, Para. 121.
- 96. ECJ, 12 December 2006, Case C-446/04, Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue, not yet reported, Para. 171.
- 97. See ECJ, 9 February 1982, Case 270/80, Polydor Limited and RSO Records Inc. v. Harlequin Records Shops Limited and Simons Records Limited [1982] ECR 329, Para. 18 et seq. regarding the free trade agreement between the EEC and the Member States and Portugal in 1972.
- 98. ECJ, 16 July 1998, Case C-264/96, Imperial Chemical Industries plc (ICI) v. Kenneth Hall Colmer (Her Majesty's Inspector of Taxes) [1998] ECR I-4695, Para. 28 and ECJ, 8 March 2001, Joined Cases C-397/98 and C-410/98, Metallgesellschaft Ltd and Others, Hoechst AG, Hoechst UK Ltd v. Commissioners of Inland Revenue, H.M. Attorney General [2001] ECR I-1727, Para. 59.

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difficulties have all been rejected by the ECJ. 99,100 This might, however, be different in a third country scenario.

First, justification based on a "prevention of tax abuse or tax avoidance" has only been accepted in abstracto so far. In ICI¹⁰¹ and subsequent decisions, ¹⁰² the ECJ has held that it accepts anti-avoidance measures only to prevent purely artificial arrangements. Consequently, the Member States must comply with the principle of proportionality. Standardized anti-abuse presumptions automatically excluding certain categories of operations from a tax advantage violate primary EC law, as the latter requires a case-by-base analysis. "Tax abuse or tax avoidance" is closely linked to the concept of the "effectiveness of fiscal supervision", which was first raised in Cassis de Dijon, 103 but which is of rather limited scope since the ECJ refers the Member States to the Mutual Assistance Directive¹⁰⁴ to obtain the necessary information. ^{105,106} Accordingly, in intra-EU situations, the ECJ has frequently rejected justifications based on this ground by referring the Member States to the means of the Mutual Assistance Directive and has held that the Member States should provide each other with mutual assistance to overcome such difficulties. It is generally expected that the ECJ would apply the same line of reasoning with regard to the recovery of tax claims, as, in this field, the 2001 amendment to the Recovery of Claims Directive 107 now requires the Member States to provide mutual assistance also in collecting direct tax claims. 108 Conversely, such a justification could have enhanced importance in the third country context. The most important reason being that these Directives do not apply in territories outside the European Union.¹⁰⁹ If this concept is accepted, differentiation between states with a tax treaty with the Member State providing for the exchange of information could be considered. 110 It, however, appears to be doubtful as to whether or not tax avoidance would be of great relevance in respect of capital movements, as passive investments are also covered by the scope of the free movement of capital.111 Another author has even argued that even standardized anti-abuse presumptions could be permissible in third country scenarios. 112

Second, the need to protect the tax base and prevent the reduction of revenue has not been accepted as a justification in an intra-EU setting. From a policy and from a legal perspective, this situation differs in relation to third countries. It has already been argued that the Community interest to secure the free movement of capital does not carry as much weight in this area as in respect of capital movements within the European Union.¹¹³ Specifically, the absence of an objective corresponding to the Single Market and the lack of power to implement harmonized rules, is a strong argument that, for example, the reduction in tax receipts could be accepted by the ECJ.¹¹⁴ Although the validity of such a broad view is questionable, as it would overdelimit the protection guaranteed by Art. 56 of the EC Treaty in third country situations, the concept may nevertheless provide some guidance, especially with regard to the taxation of foreign-source dividends. On several occasions, the ECJ has held in substance that it is sufficient to pay tax once in the European Union, regardless of which Member State collects the revenue. 115 Consequently, according to the recent Manninen¹¹⁶ judgment, a Member State must grant an imputation credit, based on the underlying foreign tax, to resident shareholders, regardless of whether or not the distributing company has been taxed by that Member State or by another Member State. Accordingly, it appears that the ECJ urges the Member States to treat taxation in other Member States not as being "foreign" in the traditional sense of international taxation. Such a policy concept, which is clearly derived from the objectives of the Internal Market, does not, however, apply equally to third countries, although the FII Group Litigation case might imply otherwise with regard to the taxation of inbound dividends. 117 In any event, it should not be ruled out that the need to protect the tax base and

99. A. Cordewener, M. Dahlberg, P. Pistone, E. Reimer and C. Romano, "The Tax Treatment of Foreign Losses – *Ritter*, *M* & *S*, and the Way Ahead (Part Two)", 44 *European Taxation* 5 (2004), p. 220.

100 C. Ph. Schindler, "EU-Report: Tax Treatment Of International Acquisitions Of Businesses", in International Fiscal Association, *Cahier de Droit Fiscal International*, Vol. 90b (Amersfoort: Sdu Fiscale, 2005), p. 51.

101. ECJ, 16 July 1998, Case C-264/96, Imperial Chemical Industries plc (ICI) v. Kenneth Hall Colmer (Her Majesty's Inspector of Taxes) [1998] ECR I-4695, Para 26

102. ECJ, 26 September 2000, Case C-478/98, Commission of the European Communities v. Kingdom of Belgium [2000] ECR I-7587, Para. 45; ECJ, 8 March 2001, Joined Cases C-397/98 and C-410/98, Metallgesellschaft Ltd and Others, Hoechst AG, Hoechst UK Ltd v. Commissioners of Inland Revenue, H.M. Attorney General [2001] ECR I-1727, Para. 57; ECJ, 12 December 2002, Case C-324/00, Lankhorst-Hohorst GmbH v. Finanzamt Steinfurt [2002] ECR I-11779, Para. 37; and ECJ, 11 March 2004, Case C-9/02, Hughes de Lasteyrie du Saillant v. Ministère de l'Économie, des Finances et de l'Industrie [2004] ECR I-2409. Para. 50.

103. ECJ, 20 February 1979, Case 120/78, Rewe-Zentral AG v. Bundesmono-polverwaltung für Branntwein (Cassis de Dijon) [1979] ECR 649, Para. 25.

104. The only decision to date on the contents of the Mutual Assistance Directive is ECJ, 13 April 2000, Case C-420/98, W.N. v. Staatssecretaris van Financiën [2000] ECR I-2847.

105. See ECJ, 28 October 1999, Case C-55/98, Skatteministeriet v. Bent Vestergaard [1999] ECR I-7641, Para. 28.

106. Schindler, note 100, p. 52.

107. See Council Directive 76/308/EEC of 15 March 1976 on mutual assistance for the recovery of claims relating to certain levies, duties and other measures, Official Journal, 1976, L 73/18, as amended, inter alia, by Council Directive 2001/44/EC of 15 June 2001, Official Journal, 2001, L 175/17.

108. For this see, for example, G. Kofler, "Hughes de Lasteyrie du Saillant: Französische 'Wegzugsbesteuerung' verstößt gegen die Niederlassungsfreiheit", Österreichische Steuerzeitung (2004), p. 195 et seq. and C. Ph. Schindler, "Hughes de Lasteyrie du Saillant als Ende der (deutschen) Wegzugsbesteuerung?", Internationales Steuerrecht (2004), p. 308 et seq. For the first indications of the ECJ's jurisprudence, see ECJ, 7 September 2006, Case C-470/04, N v. Inspecteur van de Belastingdienst Oost/kantoor Almelo, not yet reported, Para. 53 and ECJ, 9 November 2006, Case C-520/04, Pirkko Marjatta Turpeinen, not yet reported, Para. 37.

109. Schnitger, note 24, p. 494 and Ståhl, note 24, p. 54 et seq.

110. See the current Swedish case, ECJ, Pending Case C-101/05, Skatteverket

v. A, Official Journal, 2005, C 106/19.

111. See Schön, note 24, p. 517 et seq.

112. Schnitger, note 24, p. 501.

113. Ståhl, note 24, p. 54.

114. See Ståhl, note 24, p. 54 et seq. and Schön, note 24, p. 515 et seq. Doubts are raised by, for example, Schnitger, note 24, p. 494.

115. For instance, ECJ, 16 July 1998, Case C-264/96, Imperial Chemical Industries plc (ICI) v. Kenneth Hall Colmer (Her Majesty's Inspector of Taxes) [1998] ECR I-4695, Para. 26. See also M. Nichols and H. Forrest, "ECJ: If Tax Is Paid Once in the EU, Does It Matter Where?", 32 Tax Notes International (8 December 2003), p. 899 et seq.

116. ECJ, 7 September 2004, Case C-319/02, Petri Manninen [2004] ECR I-7477.

117. ECJ, 12 December 2006, Case C-446/04, Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue, not yet reported, Para. 172.

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prevent the reduction of revenue may, at least in some cases, be regarded as an overriding requirement of public interest, which may justify tax discrimination towards third countries.

Third, the countering of competition distortions could have some relevance in relation to third countries in situations in which national rules are intended to avoid the economic double taxation of distributed corporate income. Although this issue was (unsuccessfully) raised in *Lenz* by the referring Austrian Supreme Administrative Court (Verwaltungsgerichtshof) in an intra-EU context, the Commission has shown some sympathy for this argument in third country situations. It has been reported that the Commission has taken the position that a different tax treatment should be capable of being justified as a means of countering the distortion of competition, but only provided that the state of residence of the distribution company is a no or low-tax jurisdiction and the restricting domestic provision is in line with the unwritten principle of proportionality.¹¹⁸ It, therefore, appears that the Member States should be able to protect themselves against capital outflows to "tax havens", remembering that foreign low or non-taxation would effectively distort competition to the disadvantage of domestic companies.

Finally, the "coherence of a tax system" in a third country setting could require another focus other than within the European Union. According to Bachmann, 119, this justification requires a direct link between a fiscal advantage and a corresponding disadvantage of a fiscal levy, both of which must relate to the same taxpayer and the same tax. Whilst the diminishing (in concreto) acceptance of coherence in the jurisprudence¹²⁰ appeared to erode this justification, a more abstract approach to strengthen this concept has been taken in academic writing. 121 Due to the recent Manninen 122 decision, coherence again appears to have acquired a practical relevance. 123,124 Especially with regard to tax havens, which are typically outside the treaty network of the Member States, this development could be even more important. Indeed, another author has related this issue to the lack of reciprocity regarding the third country. 125

4. Grandfather Clause in Art. 57(1)

4.1. Introductory remarks

An important exception to the protection of cross-border capital movements in third country scenarios is the grandfather clause¹²⁶ in Art. 57(1) of the EC Treaty. This reads as follows:

The provisions of Article 56 shall be without prejudice to the application to third countries of any restrictions which exist on 31 December 1993 under national or Community law adopted in respect of the movement of capital to or from third countries involving direct investment – including in real estate – establishment, the provision of financial services or the admission of securities to capital markets.

The interpretation of this provision raises numerous issues, some of which have recently been clarified by or are pending before the ECJ. These are briefly considered in 4.2. and 4.3. ¹²⁷

4.2. Temporal scope of application

How should the criterion "which exist on 31 December 1993" be interpreted? In this respect, several issues must be distinguished. First, there is broad agreement in legal scholarship¹²⁸ that the legislation in question had to apply on "31 December 1993", as the provision potentially grandfathers "restrictions" and these may only be derived from the rules already applying on this date, irrespective of their date of enactment. This issue is currently pending before the ECJ in Lasertec. ¹²⁹ Second, specific issues arise if a restriction was undisputedly in existence before "31 December 1993", but was effectively disapplied by another rule that was subsequently repealed after that date, thereby reviving the pre-existing restriction. This issue is currently pending before the ECJ in Stahlwerke Ergste Westig GmbH. ¹³⁰ Third, some

118. See T. Polivanova-Rosenauer, "ECJ Rules on Austrian Discrimination of Foreign-Source Investment Income", 44 *European Taxation* 9 (2004), p. 419. 119. ECJ, 28 January 1992, Case C-204/90, *Hanns-Martin Bachmann v. Belgian State* [1992] ECR I-249, Para. 17 et seq.

120. See ECJ, 28 January 1992, Case C-204/90, Hanns-Martin Bachmann v. Belgian State [1992] ECR I-249, Para. 17 et seq.; ECJ, 28 January 1992, Case C-300/90, Commission of the European Communities v. Kingdom of Belgium [1992] ECR I-305, Para. 10 et seq.; and ECJ, 11 August 1995, Case C-80/94, G.H.E.J. Wielockx v. Inspecteur der Directe Belastingen [1995] ECR I-2493, Para. 24 et seq.

121. As early as 1994, B. Knobbe-Keuk, "Restrictions on the Fundamental Freedoms Enshrined in the EC Treaty by Discriminatory Tax Provisions – Ban and Justification –", EC Tax Review (1994), p. 81 et seq., called Bachmann an ill-fated ruling and argued for an alternative interpretation of coherence. For recent efforts, see Cordewener, note 12, p. 961 et seq.; Cordewener, Dahlberg, Pistone, Reimer and Romano, note 99, p. 221 et seq.; and Schindler, note 108, p. 305 et seq.

122. ECJ, 7 September 2004, Case C-319/02, Petri Manninen [2004] ECR I-7477, Para. 44. See also ECJ, Advocate General Kokott's Opinion, 18 March 2004, Case C-319/02, Petri Mikael Manninen [2004] ECR I-7477, Para. 49. 123. See J. Englisch, "Europarechtswidrigkeit des finnischen Körperschaftsteueranrechnungsverfahrens", Internationales Steuerrecht (2004), p. 685; A. Rust, "Renaissance der Kohärenz", Europäisches Wirtschafts- und Steuerrecht (2004), p. 450 et seq.; and A. Schnitger, "Grenzüberschreitende Körperschaftsteueranrechnung und Neuausrichtung der Kohärenz nach dem EuGH-Urteil in der Rs. Manninen", Finanz-Rundschau (2004), p. 1360 et seq.

124. Schindler, note 100, p. 52. See also, in a broader sense, F. Vanistendael, "Cohesion: the phoenix rises from his ashes", EC Tax Review (2005), p. 208 et sea.

- 125. Schnitger, note 24, p. 495.
- 126. The term "standstill clause" is also used.
- 127. For a recent and detailed analysis, see Smit, note 66.

128. Convincing is A. Schnitger, "Mögliche Wirkungsgrenzen der Grundfreiheiten des EC-Vertrages am Beispiel des § 8 KStG", *Internationales Steuerrecht* (2004), p. 636.

129. This case (C-492/04) concerns the German thin capitalization rules that were adopted on 13 September 1993, entered into force on 18 September 1993, but did not apply before 1 January 1994. Although a pending matter, this is probably quite a rare question due to the specific timing issues of the case. The request for a preliminary ruling was issued by FG Baden-Württemberg, 14 October 2004, 3 K 62/99, Internationales Steuerrecht (2005), p. 275. For further information on this case see, for example, H. Rehm and J. Nagler, "Ist § 8a KStG a. E. weltweit nicht mehr anwendbar?", Internationales Steuerrecht (2005), p. 261 et seq. and Schnitger, note 24, p. 502 et seq.

130. This case (C-415/06) was referred to the ECJ by the *Bundesfinanzhof*, 22 August 2006, R 116/04, *Bundessteuerblatt* (2006), Part II, p. 864 et seq., and concerns the judicially created prohibition of the utilization of the losses of foreign PEs in respect of a tax treaty exemption, whilst until 1998 such a prohibition was disapplied by a unilateral rule of German domestic law.

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commentators have raised the question as to the temporal limitation of "31 December 1993" in respect of Member States that acceded to the European Union after that date. The present authors submit that the stated date is relevant, irrespective of the time of accession, as Art. 57 of the EC Treaty, unlike, for example, Art. 307, does not contain a specific clause considering subsequent accession dates. ¹³¹

Finally, and most importantly, amendments to provisions "which exist[ed] on 31 December 1993" raise several issues. Specifically, it has been suggested that as long as the amendment does not affect the overall nature of the provision or even mitigates a hindrance to a treaty freedom, the amendments should not hinder the application of the grandfather clause.¹³² Based on its case law on comparable issues under other "standstill clauses",¹³³ the ECJ has recently affirmed this position:

While it is, in principle, for the national court to determine the content of the legislation which existed on a date laid down by a Community measure, the Court held in that case that it is for the Court of Justice to provide guidance on interpreting the Community concept which constitutes the basis of a derogation from Community rules for national legislation "existing" on a particular date ... As the Court stated in Konle, any national measure adopted after a date laid down in that way is not, by that fact alone, automatically excluded from the derogation laid down in the Community measure in question. If the provision is, in substance, identical to the previous legislation or is limited to reducing or eliminating an obstacle to the exercise of Community rights and freedoms in the earlier legislation, it will be covered by the derogation. By contrast, legislation based on an approach which is different from that of the previous law and establishes new procedures cannot be regarded as legislation existing at the date set down by the Community measure in

Although such a conclusion could result in practical difficulties, as each amendment of a given set of rules would require a case-by-case analysis, the denial of the grandfathering benefit as a consequence of the slightest amendment, would, of course, be easy to deal with, but inconsistent with the probable objective of the provision. It should, however, be noted that this line of case law appears to be inconsistent with the approach taken by the ECJ in the area of pre-existing international treaties of the Member States under Art. 307 of the EC Treaty. 135

4.3. Substantive scope of application

The timing issue is supplemented by the interesting question of how to interpret the categories of capital movements covered by Art. 57 of the EC Treaty, i.e. direct investments, establishments, the provision of financial services and the admission of securities to capital markets. In this respect, the *FII Group Litigation* case again gives interesting insight. First, it appears that the ECJ does not require any specificity of rules to be potentially grandfathered under Art. 57 of the EC Treaty. Accordingly, the scope of Art. 57 of the EC Treaty is not restricted to provisions exclusively focused on capital movements to and from third countries and, therefore, also covers general rules in respect of their application to third country situations. In Second, and in

line with the interpretation of Art. 56 of the EC Treaty itself, the ECJ has recourse to concepts defined in Community law in the nomenclature of the capital movements set out in Annex I to Council Directive 88/361/EEC¹⁴⁰ to interpret terms used in Art. 57. Finally, the ECJ has ended speculation that Art. 57 of the EC Treaty could be interpreted strictly as only grandfathering *direct* restrictions of certain investments without extending to payments flowing from such an investment. ¹⁴¹ Rather, the ECJ has held that:

it is clear from Article 57(1) EC that a Member State may, in its relations with non-member countries, apply restrictions on capital movements which come within the substantive scope of that provision, even though they contravene the principle of the free movement of capital laid down under Article 56 EC, provided that those restrictions already existed on 31 December 1993. ¹⁴²

131. For a different position see Staringer, note 49, p. 25. In support of the authors' view, see W. Kessler, K. Eicker and R. Obser, "Die Schweiz und das Europäische Steuerrecht – Der Einfluss des Europäischen Gemeinschaftsrechts auf das Recht der direkten Steuern im Verhältnis zu Drittstaaten am Beispiel der Schweiz –", *Internationales Steuerrecht* (2005), p. 665, note 90, and *Verwaltungsgerichtshof*, 18 October 2005, 2004/16/0243, *ecolex* 2006/104, p. 249 with comments by C. Huber and *Verwaltungsgerichtshof*, 28 January 2005, 2004/15/0105, currently before the ECJ as ECJ, Pending Case C-157/05, *Winfried L. Holböck v. Finanzamt Salzburg-Land*, Official Journal, 2005, C 143/26. This position is also strengthened by the fact that Annex IV of the 2003 Act of Accession (Official Journal, 2003, L 236/33, 797) contains a specific provision for Estonia to apply Art. 58(1) lit. a of the EC Treaty to provisions that existed on 31 December 1999 and affect capital movements between the Member States, whereas as a general rule for the other Member States that acceded in May 2004 the end of 1993 is decisive. See note 18.

132. See Schön, note 24, p. 494 with further references. Similarly, see Schnitger, note 24, p. 503; Kofler and Toifl, note 27, p. 239 et seq.; and Smit, note 66, p. 209 et seq. See also ECJ, Advocate General Geelhoed's Opinion, 10 April 2003, Case C-452/01, Margarethe Ospelt and. Schlössle Weissenberg Familienstiftung [2003] I-9743, Para. 52.

133. See ECJ, 1 June 1999, Case C-302/97, Klaus Konle v. Republic of Austria [1999] ECR I-3099, Para. 52; ECJ, 7 September 1999, Case C-355/97, Landesgrundverkehrsreferent der Tiroler Landesregierung v. Beck Liegenschaftsverwaltungsgesellschaft mbH and Bergdorf Wohnbau GmbH, in liquidation [1999] ECR I-4977, Para. 34; and ECJ, 15 May 2003, Case C-300/01, Doris Salzmann [2003] ECR I-4899, Para. 54

134. ECJ, 12 December 2006, Case C-446/04, Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue, not yet reported, Para. 191.

135. See, for example, ECJ, 5 November 2002, Case C-475/98, Commission of the European Communities v. Republic of Austria ("Open Skies") [2002] ECR I-9797, Para. 49.

136. See, for example, Peters and Gooijer, note 30, p. 477.

137. ECJ, 12 December 2006, Case C-446/04, Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue, not yet reported, Para. 174 et seq.

138. See, for example, Peters and Gooijer, note 30, p. 478 et seq., who discuss the different views taken by Netherlands courts in this respect.

139. For a different position see Smit, note 66, p. 210 et seq. and references.

140. For a detailed analysis see Smit, note 66, p. 205 et seq.

141. For a discussion of this position see ECJ, Advocate General Geelhoed's Opinion, 6 April 2006, Case C-446/04, *Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue*, not yet reported, Para. 116.

142. ECJ, 12 December 2006, Case C-446/04, Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue, not yet reported, Para. 187.

5. Conclusions

The free movement of capital guaranteed by Art. 56 of the EC Treaty is of predominant relevance for taxpayers, as its scope includes capital movements with third countries. The exact scope of this freedom is, however, all but clear. The primary question arising in this context is whether or not in third country scenarios the free movement of capital applies in the same way as within the European Union. This includes the question of whether or not the various freedoms supplement or exclude each other. Due to the fact that, for example, the freedom of establishment does not

apply vis-à-vis third countries, the importance of this question is obvious. The EC Treaty also contains provisions limiting the scope of Art. 56, which similarly raise many difficulties with regard to their interpretation. Currently, several cases are pending before the ECJ that might shed some light in the dark. Consequently, it is anticipated with great interest if and in which situations taxpayers may be able to claim Community law protection in third country scenarios under the free movement of capital.

BOOK

FU Freedoms and Taxation

Member States of the European Union have always insisted on their unrestricted national sovereignty. This book focuses on the crucial issue of the balance between the imperatives of the fundamental economic freedoms of the EC Treaty and the legitimate national interests of the Member States in protecting their national tax systems.

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- the basis and scope of the public interest justification advanced by the Member States for tax measures violating the fundamental freedoms; and
- the compatibility of the "national tax principles of the Member States" with a fully integrated market.

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